

Lessors of tangible personal property under true leases in Illinois are deemed end users of the property to be leased. See 86 Ill. Adm. Code 130.220. (This is a GIL.)

February 7, 2008

Dear Xxxxx:

This letter is in response to your letter dated June 28, 2007, in which you request information. We apologize for the delay in responding to your inquiry. The Department issues two types of letter rulings. Private Letter Rulings ("PLRs") are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department's regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter ("GIL") is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120. You may access our website at www.ILTAX.com to review regulations, letter rulings and other types of information relevant to your inquiry.

The nature of your inquiry and the information you have provided require that we respond with a GIL. In your letter you have stated and made inquiry as follows:

I am writing to receive clarification on sales and use tax issues as they would apply to a business that sells and rents medical appliances and equipment.

Transaction #1:

A patient who lives in their house receives a prescription and referral from their physician for an oxygen generating machine, assumed to qualify for the low sales tax rate if there is an applicable sale in this example. The patient, who has Medicare benefits, calls the company and orders the oxygen generating machine. The company maintains an inventory of these machines which it purchases for \$1,000 each. The company does not pay use tax at the time it purchases the machines as it does not know which machines will be rented and which machines will be sold possibly to tax exempt organizations or governmental entities.

The company delivers the machine and sets it up in the patient's home. When the company provides an oxygen generating machine to a Medicare beneficiary, it must follow the applicable Medicare regulations which include a predetermined fee schedule. For this example, assume that the fee schedule includes a \$100 delivery and setup charge, \$150 per month for months 1-36 for rental and maintenance of the oxygen generating machine. If the patient is still living in their home and using the machine on month 37, the title of the machine transfers to the patient. The monthly fee is then reduced during month 37 and on the fee is \$65 per month for maintenance of the

machine. The rental period is month-by-month and can be terminated any time if the patient no longer requires the oxygen machine or enters a hospital or other inpatient facility.

The company receives 80% of the above amount from Medicare and the remaining 20% from the patient. By Medicare regulation the company cannot charge the beneficiary more than 20% of the Medicare fee schedule to include sales tax, if applicable.

How much sales and/or use tax is to be reported each month in this example. Is this a rental requiring use tax or a sale in year 3 partly to a tax exempt government entity and partly to a private party? How should use tax be reported and paid on purchases when at the time of purchase and they are put into inventory it is not known if the goods will be rented, sold to a private party, or resold possibly to a tax exempt government entity?

Transaction #2:

A patient who lives in their house receives a prescription and referral from their physician for an oxygen generating machine. The patient, who has Private Insurance benefits, calls the company and orders the oxygen generating machine. The company maintains an inventory of these machines which it purchases for \$1,000 each. The company does not pay use tax at the time it purchases the machines as it does not know which ones will be rented and which ones will be sold.

The company delivers the machine and sets it up in the patient's home. The company has a contract with the private insurance company under the same payment terms as the Medicare fee schedule except that the insurance company can purchase the machine for the patient at any time based on a sales price of \$2,000 less a 5% reduction per month. The company delivers and sets up the machine in the patient's home for a charge of \$100. The company bills the insurance company \$150 each month for the first two months. At the beginning of the third month, the physician and insurance company determine that the machine is a good fit for the patient, the patient will probably need it for a while, and it is economically better for the insurance company to purchase the machine for the patient. The insurance company purchases the machine from the company for \$1,800.

During the first month the company received \$80 (80% of the \$100 setup) + \$120 (80% of the first month rental of \$150) = \$200 from the insurance company and \$20 (20% of the \$100 setup) + \$30 (20% of the first month rental of \$150) = \$50 from the patient. During the second month the company received \$120 from the insurance company and \$30 from the patient. During the third month the company received \$1,800 from the insurance company.

How much sales and/or use tax is to be reported each month in this example and how is it determined? In some situations, a machine could be rented for one month or less and then be sold. How would this affect the reporting and payment of sales and use tax.

Transaction #3

The company purchases a medical appliance for \$500 from a manufacturer and sells it to a patient living at home. The patient has Medicare Benefits. The company bills Medicare at the Medicare determined fee schedule amount of \$550. The company receives 80% or \$440 from Medicare. The company received the remaining \$110 from the patient's personal funds.

The \$440 collected from Medicare is non-taxable because it is received from a tax exempt governmental entity. According to Medicare regulations, the company cannot collect from the patient more than 20% of the fee schedule or a total of \$110. If sales tax is applicable on the \$110 how is it calculated? Is it determined that there was a sale of \$107.84 and \$2.16 of sales tax was collected (assuming a 2% total rate) or was there a \$110 sale and the company should pay \$2.20 out of other company funds? Or is tax not applicable in this situation since the primary purchaser and payer is Medicare?

If the patient has purchased a Medi-Gap policy from a private insurer, part or all of the \$110 coinsurance payment above could be paid by an insurance company. Would this affect the reporting and payment of sales and use tax.

If you have any questions, or require any additional information, please do not hesitate to contact me.

DEPARTMENT'S RESPONSE

The Illinois Retailers' Occupation Tax Act imposes a tax upon persons engaged in this State in the business of selling tangible personal property to purchasers for use or consumption. See 86 Ill. Adm. Code 130.101. The Use Tax Act imposes a tax upon the privilege of using in this State tangible personal property purchased at retail from a retailer. See 86 Ill. Adm. Code 150.101. If no tangible personal property is being transferred to the customers, then no Illinois Retailers' Occupation Tax or Use Tax would apply.

Likewise, the Service Occupation Tax Act and Service Use Tax are imposed on the transfer of tangible personal property incident to sales of service. See 86 Ill. Adm. Code 140.101 and 160.101. If no tangible personal property is being transferred to the customer incident to the services provided, then no Service Occupation Tax or Service Use Tax would apply.

LEASES

The State of Illinois taxes leases differently for Retailers' Occupation Tax and Use Tax purposes than the majority of other states. For Illinois sales tax purposes, there are two types of leasing situations: conditional sales and true leases.

A conditional sale is usually characterized by a nominal or one dollar purchase option at the close of the lease term. Stated otherwise, if lessors are guaranteed at the time of the lease that the leased property will be sold, this transaction is considered to be a conditional sale at the outset of the transaction, thus making all receipts subject to Retailers' Occupation Tax.

A true lease generally has no buy out provision at the close of the lease. If a buy out provision does exist, it must be a fair market value buy out option in order to maintain the character of the true lease. Lessors of tangible personal property under true leases in Illinois are deemed end users of the property to be leased. See the enclosed copy of 86 Ill. Adm. Code 130.220. As end users of tangible personal property located in Illinois, lessors owe Use Tax on their cost price of such property. The State of Illinois imposes no tax on rental receipts. Consequently, lessees incur no tax liability.

The above guidelines are applicable to all true leases of tangible personal property in Illinois except for automobiles leased under terms of one year or less, which are subject to the Automobile Renting Occupation and Use Tax found at 35 ILCS 155/1 et seq.

MEDICAL PAYMENTS

The rules regarding sales made to Medicare, Medicaid, and other government programs have not changed. Sales made to Medicare and Medicaid are exempt from tax as sales to a government body so long as the exemption is properly documented through provision of an active exemption identification number. See 86 Ill. Adm. Code 130.2080(a). This rule applies to all servicemen. While no tax may be due on payments made directly to vendors by Medicare, Medicaid, or the Illinois Department of Healthcare and Family Services, tax is due upon any portions of bills paid by individuals or private insurance companies not covered by Medicare, Medicaid, or the Illinois Department of Healthcare and Family Services. This means, for example, when Medicare directly pays 80% of the medical bill and the remaining 20% is billed to the patient or his insurance company, assuming proper documentation of the exemption, the 80% is tax exempt as a governmental payment while the 20% is taxable. 86 Ill. Adm. Code 130.2005 and 130.2007.

It is important to note that payments will only be exempt from tax when they are paid **directly** by the government agency. It is not enough that a payment to the vendor is made by a patient or insurance company and reimbursed by the government agency.

MEDICAL APPLIANCES

Concerning the tax rate for drugs, medicines and medical appliances, we refer you to the Department's regulation at 86 Ill. Adm. Code 130.310. Those products that qualify as medical appliances are taxed at the low rate of 1% plus applicable local taxes. Those that do not qualify for the low rate are taxed at the rate of 6.25% plus applicable local taxes.

The definition of medical appliance is "an item which is intended by its manufacturer for use in directly substituting for a malfunctioning part of the body." Oxygen by itself does not automatically qualify for the low rate of tax. The use that the oxygen is put to will determine whether its purchase is subject to the low rate or the standard rate. For example, if a tank of oxygen is used as part of the energy or heating supply of a cutting torch, it would not qualify for the low rate of tax. However, oxygen and oxygen tanks that are used by persons for breathing disabilities are generally subject to the low rate of tax. We do not have sufficient information about the oxygen generating machines referenced in your letter to determine whether they could qualify for the low rate of tax.

If you require additional information, please visit our website at www.ILTAX.com or contact the Department's Taxpayer Information Division at (217) 782-3336. If you are not under audit and you wish to obtain a binding PLR regarding your factual situation, please submit a request conforming to the requirements of 2 Ill. Adm. Code 1200.110 (b).

Very truly yours,

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